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In the Supreme Court of the United States

OCTOBER TERM, 1933

No. 946

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

LELAND POWERS, EXECUTOR, ET AL.

RESPONDENTS' BRIEF OPPOSING PETITION FOR WRIT OF CERTIORARI

I. JURISDICTION OF THIS COURT.

The jurisdiction of this Court is invoked by the petitioner under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925. The respondents contend that there is not presented an appropriate case for the exercise of that jurisdiction; with particular reference to the principles embodied in paragraph 5 of Rule 38 of this Court.

II. STATEMENT.

The bulk of the petitioner's statement purports to be a summary of "the facts as found by the Board of Tax Appeals" (page 2 of petition) but in fact most of it is the petitioner's own resume of the terms of a Massachusetts statute, which was quoted from verbatim by the Board (compare pages 3 to 5 of the petition with

pages 24 to 29 of the record). The Board, whose decision the Circuit Court of Appeals reversed, made its own selections from the statute and supplied italics to represent its own point of view. The petitioner's resume of these selections is not unfair, but, as will be seen below, *does not fully present the picture from the point of view of the respondents and of the Circuit Court of Appeals.*

It may be helpful to present a summary of the decision of the Circuit Court of Appeals, reported in 68 F. (2nd) 634. (References are made to the pages of the record whereat the opinion is reprinted.) The Circuit Court of Appeals held in brief as follows:

A. The Commonwealth of Massachusetts took over the Boston Elevated Railway Co. under an "unusual arrangement," whereby the Railway Company, for a consideration, turned its property over to the Commonwealth for a term of years to be managed by Public Officials,—the respondents and their co-trustees. (Pages 81-2 of record.)

B. The respondents are public officers of the State. (Pages 82-3 of record.)

C. Concededly, the operation of a street railway is not, "by classical standards," an essential function of government. (Page 83 of record.)

D. The respondents, however, among their statutory powers, were invested with powers to fix the rates of a public utility and to direct the incidence of public taxation; both of which are "by any standard essentially governmental." (Page 83 of record.)

E. Regulations 69 Article 88 does not call for an arbitrary apportionment of a salary, between

governmental and non-governmental activities; and no such contention is made. (Page 83 of record; regulation at page 82 of record.)

F. The salaries of the respondents were therefore exempt from the Federal Income Tax even under the Treasury Department's own regulations, as properly construed. (Page 83 of record.)

G. *Also,* the salaries were not taxable on broader grounds, for they represented the compensation of officers of a state, which is constitutionally exempt from Federal taxation; and as to such compensation there is no precedent for discrimination according to the presence or absence of "an essential governmental function," nor yet for discrimination according to the immediate source of the payment of the compensation. (Pages 83-4 of record.)

Propositions A to F above assert that the respondents' salaries were not taxable, even under the regulation; and thus, of course, do not involve any decision whether the regulation, properly construed, has unduly attempted to narrow the scope of the constitutional principle of exemption.

Proposition G above asserts in effect that the respondent's compensation could not constitutionally be taxed and that *if* the regulation, properly construed, should be deemed to require a different conclusion, the regulation would then be in conflict with the underlying constitutional principle.

III. Relevant Statutes.

No relevant portion of any applicable Revenue Act contains any reference to the constitutional principle of exemption which is involved.

The Treasury regulation which purports to define and circumscribe the constitutional principle is set out in the petition at page 16 and in the decision of the Circuit Court of Appeals (page 82 of record).

Certain portions of the Massachusetts Special Acts 1918, c. 159, by which the respondents' offices were created and their duties delineated, are set out at page 15 infra as an Appendix, and there is indicated by italics the bearing of portions thereof upon the respondents' contentions.

IV. Argument.

We contend that the decision of the present case in the Circuit Court of Appeals presents no issue which this Court will care to bring up for discussion on certiorari.

The actual decision in the case is summarized under headings A to F at page 2, supra. What the court has done has been to apply, in a unique situation not likely to be paralleled closely in other instances, the simple and long established rule that neither the federal nor the state government can tax the compensation of the public officers of the other.

> *Buffington* v. *Day,* 11 Wall. 113.
> *Dobbins* v. *Commissioners,* 16 Pet. 435.
> *Metcalf* v. *Mitchell,* 269 U. S. 514.
> *Willcuts* v. *Bunn,* 282 U. S. 216, 225-6.
> *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, 577.

In so doing, it has not had to touch at all upon the constitutionality of any statute; and it has not neces-

sarily invalidated any regulation of the Treasury Department, for in this particular case the public officers in question were primary officers of the state, deriving their authority directly from legislative enactment, and entrusted with a portion, sufficiently extensive to be significant, of the state's power over the rates and practices of public utilities and of the vital taxing power (page 83 of record; and Appendix, infra, pages 15, 16, 20-21).

The Circuit Court of Appeals has also said, however, that since the respondents were public officers it would not matter whether they performed "classical governmental functions" (pages 83-4 of record). We contend that there is no occasion to review the merits of this branch of the opinion; but we also point out that it is essentially a dictum, the altering of which should not affect the actual outcome of the case.

The petitioner has not reflected these distinctions in his petition; neither has he clearly adverted to the typical instances for the exercise of jurisdiction set out in subparagraph (b) of paragraph 5 of Rule 38 of this Court.

Nevertheless we proceed to answer his contentions in the order of their presentation.

1. The decision is not in conflict with

(a) *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, involving a corporation *excise tax* upon a state chartered, but privately owned and operated, public utility corporation; or

(b) *South Carolina* v. *United States*, 199 U. S. 437, involving a *license tax* imposed upon dealers

in intoxicating liquors and held applicable to individual dispensers at state dispensaries "because they were the actual sellers," but not involving any tax upon *compensation* of public officers or employees; or

(c) *North Dakota* v. *Olsen,* 33 Fed. (2nd) 848, involving a *capital stock tax* on a bank incorporated by the state and the capital stock of which was owned by the state.

The petitioner does not remark the essential differences, both in the type of tax and in the subject of the taxation, between these cases and the present case. Thus he overemphasizes differences in language and neglects differences in substantive issues, failing to bear in mind that a particular issue will frequently invoke the use of language which cannot be literally applied in another case upon a different issue.

2. The decision did not necessarily hold the regulation invalid.

The petition does not anywhere, except perhaps by implication at page 9, challenge the holding that the respondents were public officers (pages 82-3 of record).

The court below held that the respondents had some important functions of the most essential governmental character (page 83 of record). This holding the petition challenges, although but feebly, at page 11.

The court held that the regulation did not mean that a salary was to be split artificially and allocated as between services of governmental and non-governmental character (page 83 of record). This the petition challenges not at all.

Thus the particular case was held to be within the regulation as well as within the constitutional exemption; and the actual decision of the case is hardly attacked at all by the petition and fails to present the possibility of any serious conflict, upon an important question, with the decisions of this Court or of other Circuit Courts of Appeal (or of the courts of Massachusetts, to no decision of which does the petition refer).

The petition makes something (at page 9) of the point that the compensation was not paid directly by the Commonwealth. But the regulation (page 7-8 of petition) does not clearly evoke this issue (compare the first sentence with the second sentence thereof) and the holding of the court below was correct. See page 9 of this brief, infra.

United States v. *Dakota-Montana Oil Co.* 288 U .S. 459, 466 is without bearing upon the present case, for

(a) The issue there turned upon statutory and not upon constitutional law.

(b) Neither a statute nor a regulation can alter or circumscribe the constitutional principle in the present case.

(c) The Revenue Acts do not even try to deal with this principle of exemption at all, and their re-enactment can hardly do more, despite the fact of the Department having tried to deal with the subject by regulation.

In the second branch of the decision, the court below did deny precedent for the discrimination set up in the regulation. The petitioner says what the discrimina-

tion "of course" was, but neglects to point out that what the court denied was the validity of the discrimination *as applied to the compensation of a public officer,* for which neither *South Carolina* v. *United States, supra,* nor *Flint* v. *Stone Tracy Co., supra,* is any authority.

Blair v. *Byers,* 35 Fed. (2nd) 326, involved an income tax upon the annual retainer received by an attorney from a city Board of Water Works Trustees. In that case it was held that the operation of waterworks is a proprietary and not a governmental function; but it was also held that the taxpayer was not a public officer or even an employee, and the years involved were 1920 to 1923 which are governed by Section 1211 of the Revenue Act of 1926.

3. Neither the actual decision below, nor the "broader grounds" given therefor (page 83 of record) which may have been dicta, were erroneous. But even if they were it would not follow that they should be reviewed by this court.

If the actual decision were to be thought erroneous, the supposed error comes on the extremely narrow issue whether the powers of the respondents with respect to rates and with respect to taxation were, under the circumstances of this unique case, "essentially governmental." We question whether this Court will desire to review that issue for the purpose of reaching a point where for the first time the "broader grounds" of the decision (page 83) might be considered for review.

Miller v. *McCaughn,* 27 Fed. (2nd) 128, involved an income tax upon compensation paid, out of a fund contributed by surety companies, to an attorney appointed by a probate court (without statutory authority) as standing auditor to ascertain the worth of companies desiring to go surety on probate bonds. It needs little effort to distinguish such a case from that of a primary administrative state officer.

As for the source of the compensation, the position taken in the present decision (page 84 of record) is clearly right. From whatever source derived, the statutory compensation of a public officer remains "the means by which his services are procured and retained." See *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, 577.

Moreover, the burden of the salaries fell, in the last analysis, upon the Commonwealth which at the end of public operation was to take any gain and bear any loss. See Section 13, Appendix at page 20, infra. The decision, upon this narrow question of Massachusetts law, is not shown to be in conflict with any decision of a Massachusetts court or of any other court.

The latter comment applies as well to what is possibly intimated with respect to the status of the respondents (pages 9-10 of petition).

Boston Elevated Ry. Co. v. *Malley,* 288 Fed. 864, involving a federal excise tax on water transportation rates (an entirely sound decision containing on page 870 some rather inconsistent expressions) and *Boston Elevated Ry. Co.* v. *Malley,* 24 Fed. (2nd) 758, involv-

ing capital stock tax on the Railway Company, seem quite clearly not to have been (as the petitioner asserts) overruled by the present decision. It may be noted in passing that the decision makes no reference to them and that the opinion was written by the same judge who decided the second Malley case.

With respect to the essentially governmental character of the respondents' powers over rates and services, and their functions in connection with taxation, it seems sufficient to invite comparison between the provisions of the Massachusetts statute (Appendix, infra, pages 16-21), the decision of the court below (page 83 of record), and the labored language of the petition on the point (pages 11-12 of petition).

Over rates, services and facilities, the jurisdiction of the respondents was absolute,—"exclusive and . . . not subject to the approval, control or direction of any other state board or commission" (page 16, Appendix infra). The petitioner, upon the pleadings in the present case, admitted that

> "The jurisdiction of the Public Service Commission of the Commonwealth with respect to fares . . . and facilities and services of the Boston Elevated Railway was terminated and transferred to said Board of Trustees." (Pages 6 and 11 of record.)

also that

> "by virtue of said Chapter 159 said Board of Trustees became . . . a special public service commission in respect to the Boston Elevated Railway Company." (Pages 56 and 62 of record.)

The fact that the basis for rate making was prescribed by the act does not make the functions of the respondents in administering the legislative mandate any the less "essentially governmental." The authority of the trustees was not "essentially the same" as that given the company in the event of the resumption of private operation, when the company was to become "subject to public regulation and supervision" (page 21, Appendix infra) with certain limitations with respect to the net result of regulation upon revenues.

As to taxes, the trustees did more than "certify the amount of any deficit." They actually apportioned the burden (page 21, Appendix infra).

The exact extent to which the respondents exercised discretion is hardly decisive. The acts of a primary state officer are quite as governmental when he performs a duty which the legislature has defined with precision as when he exercises a delegated discretion.

And we repeat:—unless the court wishes to review this narrow issue resting primarily upon a construction of the Massachusetts statute, or the issue with respect to the source of the compensation, in the expectation of reaching a conclusion different from that of the court below, there is no issue presented by the argument in the petition competent to alter the outcome of the case.

The present case is not at all similar to *Cleveland Railway Co.* v. *Commissioner,* 36 Fed. (2nd) 347 involving an income tax upon a public utility corpora-

tion, privately operated for private profit under certain special city ordinances.

4. It seems rather doubtful whether the actual decision in this case, or even its "broader grounds," will "greatly increase the field of exemption" from federal taxation. We rather think that it will merely keep the Treasury Department from trying to circumscribe the constitutional principle, which seems to it less worthy of regard than the instant getting of revenue.

However, the principle is of equal application, as between the states and the nation,—see *Indian Motocycle Co.* v. *United States,* 283 U. S. 570, 575,—and it may be the extending activities of the federal government will at least, under the decision, be exempt from state taxation, *so far as concerns the compensation of primary administrative officers engaged in carrying out an act of congress and the policies therein embodied.*

Such cases as *Lucas* v. *Howard,* 280 U. S. 526 and *Lucas* v. *Reed,* 281 U. S. 699 cannot legitimately be described as "similar" to the present case. Those two cases (and the others cited at the bottom of page 13 of the petition) involved special services rendered by various persons, hardly to be viewed as employees and certainly not as public officers, and in no case was there any genuine participation in government. The present respondents were primary public officers, the sole administrators of a statutory policy, and, among other things, were pro tanto Public Utility Commissioners and a Board for the Apportionment of Taxes.

Reverting to the criteria of Rule 38, Paragraph 5(b).

1. The decision does not conflict with that of any other Circuit Court of Appeals on the same matter, for none of the decisions referred to were cases involving an income tax upon the compensation of an incumbent of a primary administrative office.

2. The decision, so far as it relates to local law, rests upon issues important only in a narrow context and not even suggested to be at variance with the decisions of local courts.

3. No question of general law is involved.

4. The constitutional question (raised only upon the "broader grounds" of the decision) whether the salaries of public officers may be taxed or not, dependent upon whether their functions are "essentially governmental" or not, may be an important one, but the decisions of this Court have over and over again declared the exemption in absolute terms and the issue can hardly be viewed as undecided merely because the Department has undertaken to draw some erroneous conclusions from *Flint* v. *Stone Tracy Co., supra,* and *South Carolina* v. *United States, supra.*

5. Neither the decision nor its "broader grounds" are in "probable conflict" with applicable decisions of this court.

6. Of the grounds adequate to sustain the actual decision, without embarking upon the "broader grounds," the only one which the petition really challenges is, that the powers of these particular public officers with

respect to rates and taxation were "essentially governmental." This issue alone, arising upon this unique legislation, is not of sufficient general bearing to merit review. And it is quite clear from page 14 of the petition that the petitioner is really seeking review only of the dicta referred to above as the "broad grounds."

It is respectfully submitted that the petition for a writ of certiorari should be denied.

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POWERS & HALL
Of Counsel

APPENDIX

SPECIAL ACTS, 1918

CHAPTER 159

[Italics ours]

THE COMMONWEALTH OF MASSACHUSETTS

IN THE YEAR ONE THOUSAND NINE HUNDRED AND NINETEEN

AN ACT

To provide for the Public Operation of the Boston Elevated Railway Company

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

SECTION 1. *The board of trustees* of the Boston Elevated Railway Company is hereby created, to consist of five persons *to be appointed by the governor, with the advice and consent of the council.* The persons so appointed *shall be sworn before entering upon the performance of their duties; shall own no stock or other securities of the Boston Elevated Railway Company* or of any company owned, leased or operated by it; *shall serve for the term of ten years* from the date when they assume the management of the company as hereinafter provided and until their successors are duly appointed and qualified, and each *shall receive from the company as compensation for his services five thousand dollars annually.* In case of any vacancy in said board by reason of death, resignation or otherwise, the governor, by and with the consent of the council, shall fill the vacancy. The board shall designate one of the trustees so appointed to serve as chairman. *Any member of the board may be removed for cause by the governor, with the advice and consent of the council.*

Said trustees shall not be considered public officers within the meaning of section twenty-five of chapter five hundred and fourteen of the acts of nineteen hundred and nine, but shall be subject in all other respects to the provisions of said section to the same extent as are the directors of the Boston Elevated Railway Company, but said section shall not apply to recommendations by the governor to said trustees. The provisions of section one of chapter seven of the Revised Laws shall not apply to the said board.

* * * *

SECTION 2. Said board of trustees, hereinafter called the trustees, *shall manage and operate the Boston Elevated Railway Company* hereinafter called the company, and the properties owned, leased or operated by it, for a period of ten years, commencing on the first day of the month next after their appointment and qualification, and subject to the provisions of this act, *shall take and have possession of said properties in behalf of the commonwealth during the period of operation,* and, for the purposes of this act, shall, except as is otherwise provided in this act have and may exercise all the rights and powers of said company and its directors, and, upon behalf of said company, shall receive and disburse its income and funds. They shall have the right to appoint and remove in their discretion the president, treasurer and clerk of the corporation, and all officers of the company other than the board of directors. They *shall have the right to regulate and fix fares,* including the issue, granting and withdrawal of transfers, and the imposition of charges therefor, and *shall determine the character and extent of the service and facilities to be furnished, and in these respects their authority shall be exclusive and shall not be subject to the approval, control or direction of any other state board or commission.*

In the management and operation of the said company and of the properties owned, leased or operated by it, as authorized by this act, the trustees and their agents, servants and employees shall be deemed to be

acting as agents of the company and not of the commonwealth, and the company shall be liable for their acts and negligence in such management and operation to the same extent as if they were in the immediate employ of the company, but said trustees shall not be personally liable. A majority of the board shall constitute a quorum for the transaction of business, and the action of a majority of those present at any meeting shall be deemed the action of the trustees.

Nothing herein contained shall be held to affect the right of the commonwealth or any subdivision thereof to tax the company or its stockholders in the same manner and to the same extent as if the company had continued to manage and operate its own property.

* * * *

SECTION 5. The Boston Elevated Railway Company shall, prior to or at the time of its acceptance of this act, provide for raising three million dollars in cash by the issue of preferred stock at not less than the par value which shall be one hundred dollars per share. *The issue of said stock shall not require the approval of the public service commission,* but if the remaining sections of this act fail to take effect as provided in section eighteen, such issue and the subscription thereto shall be null and void.

One million dollars shall be set aside as a reserve fund to be used for the purposes hereinafter specified, and the remaining two million dollars shall be subject to the disposition of the trustees to pay for the cost of additions and improvements to the company's property.

SECTION 6. The trustees *shall from time to time, in the manner hereinafter provided, fix such rates of fare as will reasonably insure sufficient income to meet the cost of the service,* which shall include operating expenses, taxes, rentals, interest on all indebtedness, such allowance as they may deem necessary or advisable for depreciation of property and for obsolescence and losses in respect to property sold, destroyed, or abandoned, all other expenditures and charges which under

the laws of the commonwealth now or hereafter in effect may be properly chargeable against income or surplus, fixed dividends on all preferred stock of the company from time to time outstanding, and dividends on the common stock of the company from time to time outstanding at the rate of five per cent per annum on the par value thereof during the first two years, five and one half per cent per annum on the par value thereof during the next two years and six per cent per annum on the par value thereof during the balance of the period of public operation. Dividends upon the common shares shall be payable quarterly, but no dividends shall be paid upon such common shares in excess of the rates herein specified. The first payment shall be made at the expiration of six months from the commencement of public operation, and the total of the first three quarterly dividend payments shall be five per cent on the par value of the common stock.

SECTION 7. The trustees *shall, within sixty days after their appointment and qualification, fix and put in operation rates of fare which in their judgment will produce sufficient income to meet the cost of service* as defined in section six, and within sixty days thereafter shall adopt and publish a schedule of eight different grades of fare, of which four shall be below and four above the rate of fare first established; and whenever by reason of any change in the existing rate of fare there are less than four grades, either above or below the rate then in force, the trustees shall forthwith adopt and publish a schedule of additional grades of fare so that there shall always be not less than four grades of fare above and below the existing rate of fare.

If at any time the trustees shall be of opinion that said rates of fare or schedule should be changed, either with regard to the method or basis upon which the fares and transfer privileges are established, or because the steps between the different grades are too small or too great, or for any other reason, the trustees may adopt, publish, and put in effect new schedules or rates of fare

to take the place of the existing schedule or rates of fare.

SECTION 8. The reserve fund shall be used only for the purpose of making good any deficiency in income as provided in section nine or for reimbursing the commonwealth as provided in sections eleven and thirteen, and until such use, may be invested in income-producing securities in the discretion of the trustees, and all income or interest received thereon shall be treated as part of the general income of the company.

SECTION 9. Whenever the income of the company is insufficient to meet the cost of service as herein defined, the reserve fund shall be used as far as necessary to make up such deficiency, and whenever, on the other hand, such income is more than sufficient to meet the cost of the service, the excess shall be transferred to and become a part of the reserve fund.

* * * *

SECTION 11. *If,* as of the last day of June in the year nineteen hundred and nineteen, or the last day of any December or June thereafter, *the amount remaining in the reserve fund shall be insufficient to meet the deficiency mentioned in section nine, it shall be the duty of the trustees to notify the treasurer and receiver general of the commonwealth of the amount of such deficiency, less the amount, if any, in the reserve fund applicable thereto, and the commonwealth shall thereupon pay over to the company the amount so ascertained.* Pending such payment it shall be the duty of the trustees to borrow such amount of money as may be necessary to enable them to make all payments, including dividend payments, as they become due. *If,* as of the last day of any June or December thereafter during the period of public operation, *the reserve fund shall exceed the amount originally established, the trustees shall apply the excess, so far as necessary, to reimbursing the commonwealth* for any amounts which it may have paid to the company under the provisions hereof, and the commonwealth shall thereupon distribute the amount so received among the cities and

towns in which the company operates, in proportion to the amounts which they have respectively been assessed as provided in section fourteen.

In order to meet any payment required of the commonwealth under the provisions of this section the treasurer and receiver general may borrow at any time, in anticipation of the assessments to be levied upon the cities and towns, such sums of money as may be necessary to make said payments, and he shall repay any sums so borrowed as soon after said assessments are paid as is expedient.

* * * *

SECTION 13. It shall be the duty of the trustees to maintain the property of the company in good operating condition and to make such provision for depreciation, obsolescence and rehabilitation, that, upon the expiration of the period of public management and operation, the property shall be in good operating condition. *If the period of public management and operation expires,* control of the property shall then revert to the company, *and if at that time the reserve fund shall be less than the amount originally established because the income during the period of public management and operation has been insufficient to pay the cost of the service, the commonwealth shall forthwith pay over to the company an amount sufficient to restore it to its original amount and if the amount in said reserve fund is then in excess of the amount originally established and any amount required to meet the cost of the service to the expiration of such period, such excess shall be paid into the treasury of the commonwealth* and distributed among the cities and towns in which the company operates in the same proportions as the assessments provided for by section fourteen.

SECTION 14. *In case the commonwealth shall be called upon to pay to the trustees or the company any amount under the provisions of sections eleven and thirteen, such amount* with interest or other charges incurred in borrowing money for the purpose *shall be assessed upon the cities and towns in which the com-*

pany operates by an addition to the state tax next thereafter assessed in proportion to the number of persons in said cities and towns using the service of the company at the time of said payment, *said proportion to be determined and reported to the treasurer and receiver general by the trustees from computations made in their discretion for the purpose.*

SECTION 15. Upon the termination of the period of public management and operation, the company shall manage and operate the property and may fix and collect such just and reasonable fares as will produce an income sufficient to pay the reasonable cost of the service as defined in section six, including dividends upon the common stock from time to time outstanding of six per cent per annum on the par value thereof but no more, and may establish schedules of fares which shall automatically increase or decrease in the same manner as is authorized in the case of the trustees: *provided,* that the commonwealth shall be under no liability to make any payments to the company by reason of any deficiencies in income accruing after the discontinuance of public operation. *The company shall thereafter be subject to public regulation and supervision* in such manner as may be determined by the general court, but such regulation and supervision shall not be exercised so as to reduce the income below the reasonable cost of the service as defined in this act.